SUPERIOR COURT OF CALIFORNIA

County of San Diego

DATE**: June 20, 2005**	**DEPT. 71**	**REPORTER A:**	**CSR#**
PRESENT HON. RONALD S. PRAGER		**REPORTER B:**	**CSR#**
	JUDGE		
CLERK: K. Sandoval			
BAILIFF:		**REPORTER'S ADDRESS: P.O. BOX 120128**	
		SAN DIEGO, CA 92112-4104	

JUDICIAL COUNSEL
COORDINATION PROCCEEDINGS
NO. JCCP 4221

TITLE [Rule 1550(b)]
NATURAL GAS CASES 1,11,111, AND 1V

INDEXING CASES

TENTATIVE RULING:

The General Demurrers of Defendants The Williams Companies, Inc., Williams Power Company, Inc., Duke Energy Trading and Marketing L.L.C., Duke Energy Field Services and Duke Energy North America (Defendants) to Class Plaintiffs' Master Complaint and Plaintiff City of Los Angeles Department of Water & Power's Complaint are OVERRULED.

The Motion to Strike Plaintiffs' allegations against Defendants Reliant and Zanaboni is DENIED.

The Court finds the Complaints state sufficient facts to constitute the claims alleged therein, and specifically the claims are not preempted by federal law or the filed rate doctrine.

The predominate issues before the Court are of first impression. The electricity markets and the natural gas markets are closely related, but there are distinctions between the issues before the Court. There is one undeniable distinction and one arguable distinction between the parties' positions that persuade the Court to rule in favor of Plaintiffs.

First, it is undisputed that FERC provided no remedy for the improper trading practices which are the subject of Plaintiffs' claims. While Defendants argue that Plaintiffs' only avenue of redress is with FERC, the FERC has repeatedly ruled it had no prohibitions in place and thus remedy for the improper conduct was inappropriate.

Second, the parties dispute the fact that FERC regulated the natural gas spot market. Defendants contend the Blanket Marketing Certificate under which marketers operated constituted regulation by FERC, and properly invokes the filed rate doctrine. Plaintiffs assert the Blanket Marketing Certificates

provided such slight oversight that regulation of the natural gas spot market was non-existent and therefore, the filed rate doctrine is inapplicable. The Court agrees with Plaintiffs.

Plaintiffs allegations are sufficient to put their claims outside federal regulation and therefore, federal preemption. In the main, the FERC did not exercise sufficient regulatory control over the subject natural gas markets, and in the areas in which sufficient regulation could be argued, FERC provided no remedy to the Plaintiff Class, nor to the City of Los Angeles, both of which are California consumers, retail end-users.

The face of section 717 of the Natural Gas Act expressly exempts intrastate transportation/sales and retail sales of gas for use in the state of California. Defendants contend Plaintiffs' claims implicate two layers of federal regulation. First, Defendants state FERC has the authority to regulate the transportation component of the bundled sale and the price differential between the wellhead and the border. This is true, but Plaintiffs allege their claims are for intrastate transportation and prices traded in the spot market for retail use in California. Section 717 expressly exempts these circumstances from jurisdiction of the NGA. To the extent that Plaintiffs complain about conduct regulated by FERC, such claims are ancillary to the harm alleged.

Second, Defendants state Plaintiffs claims fail because FERC has jurisdiction over the sale of the gas commodity itself. Again, it is true provided the sale is not a "first sale." Plaintiffs' claims center on "retail sales," which both parties agree are exempt from FERC regulation. (See Defendants' moving papers, p. 13:1-6)

Thus, all of Plaintiffs claims are *not* barred by the NGA since the FERC does not exercise exclusive jurisdiction over every aspect of the natural gas market. (See also, 105 FERC P. 61,217 at 16 ["Given the Commission does not have jurisdiction over the entire natural gas market, . . ."].)

Defendants state that Plaintiffs allegations that a conspiracy affected prices in "gas transportation contracts into California in the secondary (or replacement) market" (MC, para. 140) are preempted because FERC's exclusive jurisdiction over gas transportation includes that market. Defendants correctly cite, *United Gas Pipe Line Co.* (1989) 46 FERC section 61,060, where FERC concluded that "this activity constitutes the transportation of gas in interstate commerce and is subject to FERC jurisdiction under section 1(b) of the Natural Gas Act." (*Id.* at 61,263)

However, at the time of the alleged wrongful conduct FERC provided no remedy for the kind of conduct alleged. Specifically, when FERC deregulated the natural gas market, it left pricing to market forces and it assumed traditional trading practices would operate in some sort of self-regulatory manner. FERC concluded the subject gas prices were not the result of competitive conditions and did not produce just and reasonable electric prices in the California refund proceeding. (FERC, *Final Report on Price Manipulation in Western Markets*, March 2003, pp. ES-5) Further, FERC admitted Defendant Reliant conducted improper trading practices but found Reliant, and others, had not violated the blanket certificate under which these entities sold natural gas because the blanket certificates contained "no explicit guidelines or prohibitions" in this regard. (*Id.*; 105 FERC 61,008 at p.3-15, *Reliant Order* [. . . Reliant's gas trading at Topock contributed to the increased price of natural gas in California. As the Final Report notes, the trading activity of Reliant's gas buyer was not prohibited by the Commission's regulations], see also p. 5-30 *Reliant Order* [In approving the Agreement, the Commission has determined

that there was no regulation prohibiting Reliant's trading activity at Topock and no violation of Reliant's blanket certificate. Therefore, with respect to Reliant's trading activity at Topock, no remedy is appropriate].)

Since FERC had no prohibitions or guidelines concerning natural gas trading at the time of the alleged wrongful conduct, there is no remedy to Plaintiffs from FERC. Because there are no remedies from FERC, state remedies are properly available to compensate Plaintiffs for the alleged wrongful conduct.

Defendants' contention that Plaintiffs' claims relating to wholesale sales of natural gas in interstate commerce are preempted fail for the same reason. While Plaintiffs' claims are based on alleged false reporting, wash trading, and churning of wholesale natural gas transactions in interstate commerce for which FERC may have jurisdiction, at the time FERC provided no remedy for the improper trading conduct alleged to have inflated natural gas prices. Even FERC recognized there was no remedy and in 2003 implemented amendments to the blanket certificate regulations to include a code of conduct for trading practices. (18 CFR 284.402-284.403) The amendment resulted from FERC's investigation and its Final Report of the price manipulation in the western markets. (See, FERC, *Final Report on Price Manipulation in Western Markets*, March 2003, pp. ES-14, staff recommendations.)

The Court is unpersuaded by Defendants' contention that the blanket marketing certificates give FERC exclusive jurisdiction over the sales at issue. While FERC states it has exclusive jurisdiction over the wholesale gas market, including the possible wash trades, it qualifies its jurisdiction by citing to 15 U.S.C. section 3301(21) which defines "first sales." So, FERC recognizes it has limited jurisdiction. And in the absence of an appropriate remedy, Plaintiffs should not be precluded from seeking redress through state remedies.

Further, in the *Reliant FERC Order*, FERC stated Reliant had not violated FERC regulations even though the Commission was convinced Reliant's trading practices were improper and caused inflated gas/electricity rates, because FERC had no prohibitions or explicit guidelines at the time against such conduct. (105 FERC 61,008 at 29-30, *Reliant FERC Order*) A lack of remedy has since changed with the amendment to the blanket certificate statute and its implementation of the Code of Conduct concerning trading practices. (105 F.E.R.C. P61,217, Amendments to Blanket Sales Certificate, Final Rule.)

Defendants also assert that even if the sales at issue could properly be considered "first sales," Defendants conclude state law would nevertheless be preempted. It's true when Congress enacted the NGA, the states could not regulate the rates, terms or conditions on which natural gas was bought and sold at wholesale for resale in interstate commerce. Defendants contend Congress adopted the NGPA in 1978 to remove price controls from a limited category of "first sales" of gas, but even as to this limited category, state law remained preempted. Without citing any authority, Defendants conclude "[t]he NGPA constituted a Congressional determination that "first sales" not be subject to price regulation at all, neither federal or state – it did not create a vacuum to be filled by state law." No one disputes the NGPA "was intended to occupy the field of wholesale sales of natural gas in interstate commerce." But it is unreasonable to conclude from that statement that the portions of the industry the federal government does not regulate, are left completely unregulated and without recourse for wrong doing. (*Exxon Corp v. Eagerton* (1983) 462 U.S. 176, 185-86, [The NGA] states that nothing in this chapter shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price].)

While it is clear FERC has jurisdiction over some components of the natural gas industry, it does not have sufficient jurisdiction to completely preempt Plaintiffs' claims, especially in light of the fact that the areas where FERC exercises jurisdiction, there were no remedies available to Plaintiffs under the circumstances.

Defendants further argue evidence that Plaintiffs' claims are preempted lies in FERC's active exercise of jurisdiction over the conduct at issue. Defendants' point to two FERC orders specifically addressing the main subject matter of Plaintiffs' complaint (1) *Amendments to Blanket Sales Certificates*, 105 FERC P 61,217 (2003), 107 FERC P 61,174 (2004) and (2) *Order Amending Market-Based Rate Tariffs and Authorizations* 105 FERC P 61,218 (2003); 107 FERC P 61,175 (2004). These orders incorporated the new code of conduct implemented with and made conditional on all natural gas marketers, sellers, and traders. One order primarily dealt with natural gas and the other mirrored the first, but related to the electricity markets. Defendants contend these orders establish, the FERC has the ability to remedy these types of wrongs, and therefore, FERC exercises exclusive jurisdiction over the transactions at issue. (See Defendants' discussion at pp. 16:7-17:2 of Defendants' moving papers.)

Everything Defendants argue in this regard is true, and the 2003/2004 orders will provide remedies for improper trading conduct in the future. The Orders, however, leave Plaintiffs without recourse for the damages Plaintiffs suffered prior to the investigation and findings of FERC concerning the price manipulations at issue in the Complaint. It would be unjust to preclude Plaintiffs from the opportunity to remedy this wrong because FERC failed to anticipate and provide for the type of conduct used to manipulate the natural gas markets. Since, state law provides a remedy, Plaintiffs should be allowed to seek redress for any anti-competitive behavior.

Defendants also assert Plaintiffs' claims are barred by field preemption and conflict preemption. In support of this contention Defendants cite *Public Utility District No. 1 of Snohomish County v. Dynergy Power Marketing, Inc.* (*Snohomish*) (S.D. Cal. 2003) 244 F.Supp2d 1072, 1080-85, *aff'd* 384 F.3d 756 (9th Cir. 2004) and *T & E Pastorino Nursery v. Duke Energy Trading & Mktg. L.L.C.* Nos. MDL 1405, CV-02-2178-RHW, et. al. 2003 WL 22110491 (S.D. Cal. Aug. 27, 2003) (*Pastorino*), *aff'd* 2005 WL 434485 (9th Cir. Feb. 25, 2005) Both *Snohomish* and *Pastorino* [unpublished decision] are federal cases that were decided under the Federal Power Act (FPA) and dealt specifically with electricity price manipulations. The parties in Snohomish were a wholesale electrical power company and a public utility company in the business of buying and selling electricity for resale.

Each court found the FPA gave exclusive jurisdiction to FERC in rate setting and regulation over electricity. The courts also concluded that the plaintiffs attempted to interfere with the rate setting authority vested in FERC to determine that filed electricity rates and/or tariffs were just and reasonable.

These cases are inapposite to the facts asserted in Plaintiffs' complaint. Not only are they based on electric power authorities, the FERC also provided a remedy for the wrong doing found. It is well known and often discussed that FERC determined certain parties engaged in improper trading conduct in the electricity markets. FERC investigated, made findings *and* provided remedies in the way of refunds for inflated electricity rates.

The plaintiffs in *Snohomish* and *Pastorino* were not left without redress as would Plaintiffs be in this case. (See *In re California Retail Natural Gas and Electricity Antitrust Litigation* (2001) 170 F.Supp.2d 1052; *In*

***re Western States* (2004) 346 F.Supp.2d 1123; *E & J Gallo* Winery *v. Encana Energy Services, Inc. et. al.* (2004) CV F 03-5412 AWILJO, Memorandum Order and Opinion Denying Defendants' Motion to Dismiss All Claims and Denying Motion to Strike)**

Defendants Reliant and Zanaboni contend Plaintiffs' claims relating to "churning" are preempted because the FERC has already addressed this specific issue. (*See* 105 FERC section 61,008 (2003) (*Reliant FERC Order*).) It's true FERC reviewed the trading practices of Reliant and the Commission found "Reliant profited from churning in both the physical and financial markets. In doing so, Reliant adversely impacted prices to such a significant degree that remedial action is justified. . . ." However, FERC concluded there was no regulation prohibiting Reliant's trading activity at Topock and no violation of Reliant's blanket certificate. Therefore, with respect to Reliant's trading activity at Topock, no remedy is appropriate." (105 FERC section 61,008, *supra*, citing, FERC, *Final Report on Price Manipulation in Western Markets*, March 2003, pp. II-60-II-61)

Again, FERC left Plaintiffs with no remedy for the improper trading practices of Reliant. Consequently, the Court denies Defendants' motion to strike allegations of Reliant's churning and overrules the demurrer in this regard.

Finally, Defendants contend the filed rate doctrine bars Plaintiffs' claims. It's true FERC has held that a "blanket [gas] certificate has the same legal effect as the market based rate authority granted to sellers in the wholesale electric market" at issue in the above cases. (*Reliant FERC Order*, 105 FERC 61,008, at 29) But Defendants' reliance on Commissioner Massey's statement in support of Defendants' contention is taken out of context and selectively quoted.

Defendants state Commissioner Massey "has noted that the FERC regulations constitute 'tariff conditions' and give FERC 'the tools to sanction such bad behavior.' (Defendants moving papers, p. 28:3-4, citing, Amendments to Blanket Sale Certificates (2003) 105 FERC 61,217 (Massey, Comm'r Concurring) Commissioner Massey's statements were made *after* the Commission determined there had been an abuse of trading and *after* the Commission realized it had no remedy under FERC regulations for such conduct. In approving the amendments to the Blanket Sales Certificates, Commissioner Massey stated, the Commission *now* has the tools to sanction such bad behavior and [the Commission] give[s] notice of what some of those sanctions could be. This action should help to *restore the faith* in energy markets that has been lost in the last few years." (Amendments to Blanket Sale Certificates, 105 FERC 61,217 (Massey, Comm'r Concurring), emphasis added)

FERC obviously has a mechanism for filing natural gas rates for long term contracts. (See 15 U.S.C. section 717(c).) The natural gas spot market, however, cannot comply with section 717c for obvious logistical reasons. Therefore, "spot market" trading of natural gas, by its nature, cannot implicate the filed rate doctrine. To the extent that subsequent FERC rules and regulations ameliorates this regulatory flaw, no such regulation existed at the time of the alleged improper conduct. (See *In re California Retail Natural Gas and Electricity Antitrust Litigation* (2001) 170 F.Supp.2d 1052; *In re Western States* (2004) 346 F.Supp.2d 1123; *E & J Gallo* Winery *v. Encana Energy Services, Inc. et. al.* (2004) CV F 03-5412 AWILJO, Memorandum Order and Opinion Denying Defendants' Motion to Dismiss All Claims and Denying Motion to Strike)

Finally, Plaintiffs correctly point to *Cal. ex rel. Lockyer v. FERC* (9th Cir. 2004) 383 F.3d 1006, a federal electricity case that discusses the filed rate doctrine. It is instructive here because the discussion on the filed rate doctrine specifically addresses analogous flaws in the regulatory aspects of the natural gas market. *Cal. ex rel. Lockyer* states "a market-based tariff cannot be structured so as to virtually deregulate an industry and remove it from statutorily required oversight. The structure of the tariff complied with the FPA, so long as it was coupled with enforceable post-approval reporting that would enable FERC to determine whether the rates were "just and reasonable" and whether market forces were truly determining the price." *Cal. ex rel. Lockyer also states* "because the reporting requirements were an integral part of a market-based tariff that could pass legal muster, FERC cannot dismiss the requirements as mere punctilio. If the ability to monitor the market, or gauge the "just and reasonable" nature of the rates is eliminated, then effective federal regulation is removed altogether. Without the required filings, neither FERC nor any affected party may challenge the rate. Pragmatically, under such circumstances, there is no filed tariff in place at all." (*Cal. ex rel. Lockyer v. FERC* (9th Cir. 2004) 383 F.3d 1006, 1014-1017)

Defendants are ordered to Answer the Complaints within ten days of this ruling.